



SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-96694; File No. SR-LCH SA-2023-001]

**Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change
Relating to the Liquidity Risk Model Framework**

January 18, 2023.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 4, 2023, Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change (“**Proposed Rule Change**”) described in Items I, II and III below, which Items have been primarily prepared by LCH SA. The Commission is publishing this notice to solicit comments on the Proposed Rule Change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

LCH SA is proposing to amend its Liquidity Risk Model framework (the “**Framework**”), which describes the framework by which the LCH SA Collateral and Liquidity Risk Management (“**CaLRM**”) team assures that LCH SA has enough cash available to meet any financial obligations, both expected and unexpected, that may arise over the liquidation period for each of the clearing services that LCH SA offers.³ The

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ LCH SA, a subsidiary of LCH Group, manages its liquidity risk pursuant to, among other policies and procedures, the Group Liquidity Risk Policy and the Group Liquidity Plan applicable to each entity within LCH Group. In addition to its CDSClear service, LCH SA provides clearing services in connection with cash equities and derivatives listed for trading on Euronext (EquityClear), commodity derivatives listed for trading on Euronext (CommodityClear), and tri-party Repo transactions (RepoClear).

Framework is part of LCH SA's Risk Management Procedures (the "**Procedures**") and it is consistent with LCH group liquidity risk policy to which LCH SA shall comply.

The text of the Proposed Rule Change is in Exhibit 5 [sic].⁴

The implementation of the Proposed Rule Change will be contingent upon LCH SA's receipt of all necessary regulatory approvals, including the approval by the Commission of the Proposed Rule Change described herein.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, LCH SA included statements concerning the purpose of and basis for the Proposed Rule Change and discussed any comments it received on the Proposed Rule Change. The text of these statements may be examined at the places specified in Item IV below. LCH SA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Framework is one of several well-developed policies and procedures that LCH SA maintains to manage its liquidity risk, *i.e.*, the risk that LCH SA will not have enough cash available, in extreme but plausible circumstances, to settle margin payments or delivery obligations when they become due, in particular upon the default of a clearing member. Such policies and procedures include, among others:

- (i) the Group Liquidity Risk Policy which ensures that each CCP of the LCH group has enough liquid resources on hand to meet all the expected and unexpected financial obligations that arise during the course of the day. The

⁴ Capitalized terms used but not defined herein shall have the meaning specified in the CDS Clearing Rule Book or the Clearing Supplement, as applicable.

policy lays out how a CCP will measure whether there is enough available liquid resources;

- (ii) the LCH SA Liquidity Plan that sets out the principles and procedures for liquidity management within LCH SA. Its main objectives are to:
 - Ensure the liquidity adequacy of LCH SA at all times in accordance with policies set by the appropriate governance authority monitored and reported by Risk Management;
 - Ensure that liquidity management and resources are aligned with LCH SA operational requirements to meet payment obligations as they fall due under Business as Usual and stressed liquidity conditions;
 - Ensure effective liquidity risk identification and escalation within Collateral and Liquidity Management (“**CaLM**”) service and other relevant departments with LCH SA.
- (iii) the Group Financial Resource Adequacy Plan which details the standards by which financial resources should be assessed against member exposures. This includes Variation Margins, Initial Margins, Margin Add-Ons for liquidity risk, concentration risk, wrong way risk where appropriate, as well as the sizing and re-sizing of the default funds across the LCH Group CCPs;
- (iv) the Group Collateral Risk Policy; which sets out the standards for the management of collateral risk across the LCH Group CCPs and ensures that CCPs must have a robust mechanism in place to process and control the collateral posted by members;
- (v) the Group Investment Risk Policy which sets out the standards for the management of investment risk across the LCH Group CCPs;
- (vi) the LCH SA Collateral Control Framework which describes the actions undertaken by the CaLRM team to implement the collateral limits laid out in

the Group Collateral Risk Policy and to ensure that the prices integrated on a daily basis by margin team are accurate and fairly priced.

In brief, the Framework: (i) identifies LCH SA's sources of liquidity and corresponding liquidity risks; (ii) identifies LCH SA's liquidity requirements with respect to its members and its interoperable central counterparty ("CCP");⁵ (iii) describes the metrics and limits that LCH SA monitors; and (iv) describes the scenarios under which these metrics are computed.

- (i) Default Fund reduction and intraday injection of liquidity in the settlement platform to be considered in operational target ⁶.

As per a recommendation from LCH SA's independent risk model validation department⁷, LCH SA is proposing to amend the Framework in order to address more accurately its liquidity requirements in the event of a Default Fund ("DF") scheduled reduction⁸ or an extraordinary intraday liquidity injection⁹ in the settlement platform.

⁵ LCH SA has an interoperability agreement with Cassa di Compensazione e Garanzia ("CC&G"), an Italian CCP, pursuant to which LCH SA's clearing members and CC&G's clearing members are able to benefit from common clearing services without having to join the other CCP. Each CCP is a clearing member of the other one with a particular status when accessing the clearing system of the other counterparty.

⁶ The Operational target represents the amount of liquidity to be held to satisfy the liquidity needs related to the operational management of the CCP in a stressed environment that does not lead to a member's default

⁷ Only proposed changes described in (i) are due to model validation recommendation

⁸ Every first business day of the month the CCP recalibrate its DF amounts according to its internal procedures. If the amounts recalibrated are lower than the amounts in force resources will be returned to members accordingly within the 4th business day of the month. Moreover only global reduction in DF amounts are considered in the calculation of operational target. Increases in DF would augment the available liquidity and reduce the Operational target and therefore are not considered.

⁹ When volumes in the settlement platform are particularly high the treasury department may need to inject additional liquidity during the day to ensure the smooth function of the settlement flows

Before any DF change there exists a latency between the final approval of the new DF total amount and the settlement of the new contributions. To properly reflect the decrease of the DF in the calculation of the operational target until the settlement of the contributions the new proposed framework will include the following enhancements.

- The DF recomputed is compared to the DF actually paid and in the account of LCH SA.
- The amount that will reported will be the following.
 - only global drain of liquidity will be considered and added to the operational target because they represent a scheduled liquidity outflow that needs to be covered by adequate liquidity resources by the CCP,
 - Eventual negative amounts will be reported in the operational target for all the days from the beginning of the month till settlement date.

Moreover, according to the current internal fails monitoring operating mode, a threshold of 1 bln Euro is set to request a formal approval by the LCH SA Chief Risk Officer and the Head of LCH SA CaLM or their delegates, before allowing the LCH SA Operations team to inject extraordinary liquidity intraday in the settlement platform.

The current liquidity framework does not take into consideration eventual extraordinary liquidity injection in the settlement system in the calculation of the operational target. The revised liquidity framework, while maintaining consistency with the current procedure, will require a rerun of the operational target anytime a significant amount (bigger or equal than 1 bln Euro) of liquidity is injected intraday. Eventual intraday injection will be subtracted from the liquidity resources available that are compared against the operational target to ensure that LCH SA has adequate liquidity to satisfy the needs related to the operational management of the CCP

(ii) Committed credit line.

LCH SA is proposing clarifications to the Framework to reflect the final closure of one committed credit line that took place the December 15th 2021. The committee credit line with Kas bank has been replaced by a multi-currency overdraft facility of €10 million with an International bank. In addition the CCP put in place a secured committed intraday credit line with Norges Bank to cover the non-Euro VM payments for the Euronext Oslo listed derivatives activity. The amount of the Norges bank credit line is flexible and is determined on a daily basis based on the collateral deposited with Euroclear Bank.

Finally, in accordance with what is defined in the SA liquidity Plan, it has been reported in the Framework the list of options that LCH SA has to address in a default situation any liquidity shortfall in a currency different from EUR. These are:

- The non EUR cash deposited as collateral
 - The sale of the non EUR securities of the defaulting member
 - Repo transactions
 - Bilateral Repo transactions (Non Euro cash taker and Non Euro collateral giver)
 - Cross-currency Bilateral Repo (Non Euro cash taker and Euro collateral giver)
 - Cross-currency Triparty Repo (Non Euro cash taker and Euro collateral giver)
 - The use of the multicurrency overdraft facility with an International Bank
 - Use of the FX spot market transactions
 - ECB weekly tender in USD (last resort). Given its banking status, LCH SA has access to the ECB Open market operations in USD.
 - Replace LCH SA's liabilities in non EUR by EUR as per clearing rulebook
- (iii) Updated figure of maximum limit of liquidity injected in the settlement system to ease settlement

In the section of the Framework that describes how the settlement of physical securities is made and how such activity impact the liquidity of the CCP, LCH SA is updating the maximum level of liquidity to be injected daily in the settlement system to ease settlement flow.

In particular, the CCP have defined for each Central Securities Depository (CSD) in which settlement takes place an amount of liquidity that is injected everyday to ease the settlement flow and such liquidity consumption is monitored by Operation team during the settlement cycle that occurs throughout the day.

The updated figures have been defined as a function of the actual settlement activity observed by Operations team to optimize the management of the CCP liquidity.

Moreover, in the same section of the Framework, it is described the mechanism of auto-collateralization which is a feature of T2S that enables to obtain the liquidity necessary to the finalization of transactions by pledging the security underlying the transaction at the Central Bank to get cash. It has been clarified that LCH SA successfully managed to test the transfer to its 3G pool (central bank liquidity) of securities coming from settlement for Italy, Spain and Germany transactions.

2. Statutory Basis

LCH SA has determined that the Proposed Rule Change is consistent with the requirements of section 17A of the Act¹⁰ and regulations thereunder applicable to it. section 17A(b)(3)(F) of the Act requires, *inter alia*, that the rules of a clearing agency “assure the safeguarding of securities and funds that are in its custody or control or for which it is responsible.”¹¹

LCH SA believes that the Proposed Rule Change is consistent with the requirements of section 17A of the Act and regulations thereunder applicable to it, including Commission Rule 17Ad-22(e). In particular, section 17A(b)(3)(F) of the Act requires, *inter alia*, that the rules of a clearing agency be designed to “promote the prompt and accurate clearance and settlement of derivatives agreements, contracts, and

¹⁰ 15 U.S.C. 78q-1

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

transactions”. The proposed changes in the Operational target described above under Item 3(1)(i) enhance the ability of LCH SA to manage its liquidity during the daily services it provides by properly anticipating potential scheduled needs (Default Fund reductions) as well as ensuring that the liquidity available is always sufficient to continue the clearing and settlement operations also in the event of extraordinary intraday liquidity injection in the settlement systems. The new proposed rule will further strengthen the robustness of the liquidity management of the Clearing Agency thus contributing to the prompt and accurate clearance and settlement of securities transactions. The proposed changes described above also provide the details about the means the Clearing Agency has to deal with liquidity shortfalls in non Euros that may arise during a default situation. By being allowed to leverage on different options the Clearing Agency has the ability to address such liquidity shortfalls without impacting its services and therefore promoting the accurate clearance and settlement of securities transactions. Finally, the proposed changes described under item (1) (iii) represent mainly an update of the figures of the liquidity amounts used for easing settlement in the different CSD that LCH SA uses. This update is the result of a periodic review performed by the LCH SA Operation team to optimize the liquidity management of the clearing house. By ensuring that the liquidity injected is proportional to the settlement activity the clearing house is promoting the prompt and accurate settlement of securities.

As discussed above, LCH SA is proposing to amend the Framework to address specifically LCH SA’s liquidity requirements in the event of Default Fund reduction or extraordinary intraday injection of liquidity in the settlement platforms. The proposed amendments will assist LCH SA in defining more accurately its liquidity requirements by assuring that LCH SA will maintain appropriate levels of liquidity. Specifically, the amended Framework will anticipate the effect of scheduled reductions to the Default

Fund amount or recalculate the liquidity indicators whenever significant extraordinary liquidity is injected intraday in the settlement systems.

The policies and procedures set out in the amended Framework, therefore, are designed to enhance LCH SA's ability to measure, monitor, and manage the liquidity risk that may arise in connection with its activities as a covered clearing agency. As such the amendments to the Framework regarding LCH SA's liquidity requirements are consistent with the requirements of Regulation 17dA-22(e)(7)(i)¹² requiring that a covered clearing agency's policies and procedures be reasonably designed to ensure that it maintains sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that includes the default of the participant family that would generate the largest aggregate payment obligation for it in extreme but plausible market conditions and also with Regulation 17dA-22(e)(7)(ii)¹³ requiring a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it holds qualifying liquid resources sufficient to meet the minimum liquidity resource requirement in each relevant currency for which the covered clearing agency has payment obligations owed to clearing members.

¹² 17 CFR 240.17Ad-22(e)(7)(i)

¹³ 17 CFR 240.17Ad-22(e)(7)(ii)

B. Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.¹⁴ LCH SA does not believe the Proposed Rule Change would have any impact, or impose any burden, on competition. The Proposed Rule Change does not address any competitive issue or have any impact on the competition among central counterparties. LCH SA operates an open access model, and the Proposed Rule Change will have no effect on this model.

C. Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. LCH SA will notify the Commission of any written comments received by LCH SA.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

¹⁴ 15 U.S.C. 78q-1(b)(3)(I).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-LCH SA-2023-001 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-LCH SA-2023-001. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of LCH SA and on LCH SA's website at: <https://www.lch.com/resources/rulebooks/proposed-rule-changes>. All comments

received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-LCH SA-2023-001 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Sherry R. Haywood,

Assistant Secretary.

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¹⁵ 17 CFR 200.30-3(a)(12).